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Report to the Chairman, Subcommittee on Treasury, Postal Service, and General Government Senate Committee on Appropriations

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# CONTRACTING

# Revised Per Diem Cost Principle Effect on Defense Contractors

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GAO

**United States**
**General Accounting Office**
**Washington, D.C. 20548**

**National Security and**
**International Affairs Division**

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December 2, 1987

The Honorable Dennis DeConcini
Chairman, Subcommittee on Treasury,
Postal Service, and General Government
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

As you requested, we reviewed Public Law 99-234 to determine if the law treats contractors fairly. Our objective was to provide the Committee with readily available information to help address the concerns raised by defense contractors. Major defense contractors stated that Public Law 99-234 is unfair because their employees cannot obtain hotel or motel room discounts equal to the discounts granted government employees on official travel. They contend that without access to these rates, their employees cannot travel within the federal per diem limits set by the General Services Administration (GSA). As agreed with your representative, we modified the scope of our work to obtain readily available data in order to make an initial assessment. The results of our review are summarized below and more fully discussed in the appendix.

Senate Report 99-406, dated August 14, 1986, contained a provision for us to obtain extensive detailed statistical information to determine the effect of Public Law 99-234, governing the allowability and reasonableness of travel costs incurred by government contractors. This law, enacted on January 2, 1986, and effective as of July 31, 1986, states that the government will consider per diem travel costs of government contractors to be reasonable and allowable only to the extent that they do not exceed those maximum levels set for federal employees.[1]

Based on our review, it is premature to conclude whether Public Law 99-234 is or is not treating government contractors fairly because of (1) limited available equivalent contractor per diem cost data, (2) recent efforts by GSA to negotiate government rate discounts with hotels and motels for government contractors, and (3) government contractors' efforts to reduce costs.

[1]Per diem consists of a daily flat rate payment instead of actual expenses for subsistence and covers lodging, meals, and other incidental expenses for the personal sustenance and comfort of the traveler. Per diem does not include transportation charges.

As agreed with the Committee's representative, we did a limited analysis of contractor per diem costs by asking eight major defense contractors to provide us with travel cost information. However, we received different information from the eight contractors. The volume of travel and the different accounting systems used by the contractors influenced the type and completeness of information which they provided.

We compared the data provided by the eight contractors and found considerable differences in the per diem costs reported for the same locations by the contractors. The limited data showed that in most cases these per diem costs did not exceed the government per diem limitations, but we cannot conclude whether contractors are being treated fairly or unfairly under Public Law 99-234 because our results are not based on a statistically valid sample, and therefore, cannot be used as a basis for general conclusions about all federal contractors. Also, the limited preliminary data did not include small or civilian agency contractors. Because the new travel regulations, for some contractors, apply only to contracts resulting from proposals or solicitations issued after July 31, 1986, we could not determine whether the contractors' travel per diem costs reflect efforts that meet the new travel regulations.

According to seven of the contractors, they have made efforts to obtain discount rates from hotels and motels. In addition, GSA has obtained discount rates at selected hotels and motels for government contractors. According to the Chairman, Defense Acquisition Regulatory (DAR) Council, Committee on Commercial Cost Principles, contractors now have more incentive to talk to hotels and negotiate more favorable rates. Under the previous travel cost reimbursement system, "adequate and reasonable" travel costs were not specifically defined, leaving contractors with no incentive to try to keep hotel costs down. However, five of the eight contractors stated they have not changed their travel cost reimbursement policies in response to Public Law 99-234.

It is too early to fully assess the effect of the new travel regulations on contractors. Sufficient time should elapse to allow the contractors' and GSA's efforts to obtain discount lodging rates to have an effect, and to have sufficient numbers of travel vouchers processed under the new travel regulations to assess. The Chairman of the DAR Council Committee on Commercial Cost Principles said data will not be available to compare unallowable costs under the old and new systems until around December 1987. In addition, Defense Contract Audit Agency officials said it will not be until fiscal year 1988 before it would be able to start auditing travel costs. According to these officials, contractors are not required to

provide the auditors with information on costs incurred until 3 months after the end of the corporate fiscal year. Most contractors' fiscal years end June 30, therefore, the auditors will not receive this information for review until about October 1987.

We obtained official comments from the Secretary of Defense; Administrator, General Services Administration; and the eight contractors surveyed. They all generally concurred with our conclusion. The objectives, scope, and methodology of this review are discussed in appendix I.

We are sending copies of this report to the Secretaries of Defense, Air Force, Army, and Navy; the Director, Defense Logistics Agency; and to the Administrator, General Services Administration. Copies will also be made available to the contractors surveyed and other interested parties upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Assistant Comptroller General

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**Abbreviations**

| | |
|---|---|
| DAR | Defense Acquisition Regulatory |
| GSA | General Services Administration |

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# Comparison of Contractor Per Diem Costs

## Background

Before the enactment of Public Law 99-234, the Federal Procurement Regulations allowed government contractors to charge travel costs, including per diem charges (lodging, meals, and incidental expenses), to government contracts as long as the charges were considered reasonable. However, no specific criteria existed to determine what was reasonable. Under Federal Acquisition Regulations implementing Public Law 99-234, contractor per diem costs are to be considered reasonable and allowable only to the extent that they do not exceed, on a daily basis, the maximum per diem rates set out in the Federal Travel Regulations.

These rates, set by GSA, govern per diem reimbursements to federal employees. Government employees are restricted to a maximum lodging amount and a fixed rate for meals and incidental expenses within each per diem rate. The new regulations governing contractor reimbursements, on the other hand, do not set lodging, meal, and incidental expenses limits within each maximum per diem amount.

In keeping with Public Law 99-234, contractors were not subject to the new travel cost principle until they received a contract award resulting from a solicitation issued on or after July 31, 1986. However, the DAR Council approved a change in the effective date for use by all Department of Defense contracting officers. This change gave contracting officers the option of waiting until January 1987 to begin applying the new cost principle to applicable contracts. According to the Chairman, DAR Council, Committee on Commercial Cost Principles, this allowed contractors time to modify or adjust their accounting systems to apply the new travel cost principles in requesting reimbursement from the government. However, to do this, the contractor had to agree that all travel costs after January 1, 1987, not just those incurred as a result of new contracts, would be subject to the new principle. Of the eight contractors we questioned, only three elected to defer implementation—two waited until January 1, 1987, and the other waited until October 1, 1986.

## Objectives, Scope, and Methodology

As requested by the Chairman, Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, we reviewed the effect Public Law 99-234 is having on contractors to determine if the law treats contractors fairly. Some major defense contractors stated that Public Law 99-234 is unfair because their employees cannot obtain government discount rates at hotels and motels equal to those granted government employees. These contractors contend that without

access to government hotel and motel discount rates, their employees cannot travel within the federal per diem limits set by GSA.

During our work, we obtained information from DAR and Federal Acquisition Regulatory Councils, the Defense Contract Audit Agency, and GSA officials. We also asked selected major defense contractors located throughout the United States to provide us with per diem cost information. We obtained data from eight contractors to test the availability of information on per diem costs before assessing whether to perform a valid statistical sample of defense contractors. We selected major defense contractors because they would be more likely to have systems in place to readily provide per diem cost information than would smaller contractors. We chose divisions of these eight contractors which have resident government contract administrators—two each with Army, Navy, Air Force, and Defense Logistics Agency plant representative offices. The eight contractor divisions or subsidiaries and their locations are as follows.

- Boeing-Vertol Company, a division of the Boeing Company, Philadelphia, Pennsylvania;
- Convair, a division of General Dynamics, San Diego, California;
- Grumman Aircraft Systems Division, a division of Grumman Aerospace Corporation, Bethpage, Long Island, New York;
- Lockheed-Georgia Company, a division of the Lockheed Corporation, Marietta, Georgia;
- McDonnell Aircraft Company, a division of McDonnell Douglas Corporation, St. Louis, Missouri;
- Equipment Division Laboratories, a division of the Raytheon Company, Burlington, Massachusetts, and Division Headquarters, Lexington, Massachusetts;
- North American Aircraft Operations, a division of Rockwell International Corporation, Los Angeles, California; and
- Bell Helicopter Textron Inc., a subsidiary of Textron, Inc., Fort Worth, Texas.

In March 1987, we requested per diem costs and travel policy information from the eight contractors. We asked each contractor to tabulate, by city, employees' average per diem costs for all of those cities that together comprised 80 percent of the contractor's per diem costs for January and February 1987. We then compared the per diem costs provided by the contractors against the maximum per diem levels outlined in the Federal Travel Regulations. We also asked these contractors for information on revised travel policies and efforts they have made to

obtain discounts for government contract employees at hotels and motels.

Because our analysis used per diem cost averages, we were not able to determine the actual unallowable costs experienced by the contractors. However, two contractors stated that they modified their policy to limit reimbursement for their employees not to exceed maximum per diem. The contractors are required to compare daily costs versus federal travel rates, and any offset of overruns by underruns to the daily rates is not permitted. Therefore, the per diem cost averages cannot be compared against the government per diem rates to determine the amount of unallowable per diem costs. In addition, because the new travel regulations apply only to contracts resulting from solicitations issued on or after July 31, 1986, we have no assurances that the per diem costs provided by all contractors were required to meet the per diem rates established by the new travel regulations.

Our review was performed from December 1986 to July 1987 in accordance with generally accepted government auditing standards.

## Comparison of Data Provided a Mixed Result

Although we asked each contractor to provide specific travel policy and cost information, there were differences in the data we received. For example, two contractors said that because of their accounting systems and volume of travel, they could only provide a random sampling of the January and February 1987 expense reports. According to another contractor, it provided a representative list of most frequently traveled locations. However, because of the new travel policy implementation, travel vouchers for January and February were delayed and the information provided was not representative of a normal 2-month period.

We did not include one contractor in the per diem cost comparison because it was not able to provide meal and incidental expense costs. However, as shown in table I.1, we compared the data provided by the other seven contractors, labeled "A" through "G", against the maximum per diem rates allowed by the Federal Travel Regulations. The eighth contractor is included as contractor "H" in our comparison of lodging costs in 10 high-travel cities. (See table I.3.)

As shown in table I.1, five of the seven contractors had per diem cost averages no more than $5.00 above the federal per diem rates 50 percent of the time. Of these contractors, three reported average per diem rates at $5.00 or less above the federal rates almost 80 percent of the

time. However, contractor E reported per diem costs $5.00 or less above the federal rates only 13 percent of its total travel days. Over 81 percent of its travel days were more than $15.00 above the federal per diem rates.

**Table I.1: Contractor Per Diem Costs Compared to Government Per Diem Rates[a]** (In percentages)

Figures in percent

| Contractors[b] | Less than or equal to govt. rate | Amounts greater than govt. per diem rates | | | Not able to determine |
|---|---|---|---|---|---|
| | | $.01 to $5.00 | $5.01 to $15.00 | $15.01 and above | |
| A | 77.5 | 2.1 | 12.7 | 4.2 | 3.5 |
| B | 53.1 | 4.5 | 11.9 | 30.5 | 0 |
| C | 59.6 | 25.0 | 10.7 | 4.6 | 0 |
| D | 79.9 | 2.6 | 16.3 | 1.2 | 0 |
| E | 8.6 | 4.4 | 5.5 | 81.5 | 0 |
| F | 48.6 | 12.7 | 14.8 | 23.9 | 0 |
| G | 26.2 | 5.5 | 32.5 | 33.6 | 2.1 |

[a]We used the maximum federal per diem rates that were in effect during January and February 1987. GSA has increased the federal per diem rates effective August 1, 1987.

[b]We did not include one contractor in the per diem cost comparisons because it was not able to provide meal and incidental expense costs.

## Contractors' Per Diem Costs at Same Locations Differ

The seven contractors provided cost information which totaled 23,240 travel days and represented 326 different locations. Over 90 percent of these travel days were at only 67 different locations. The top 10 locations, as shown in table I.2, accounted for almost 54 percent of all travel days.

Looking only at the 10 most-traveled locations based on travel days, we found large differences among contractors' per diem costs. (See table I.2.) For example, in Los Angeles, the average per diem costs ranged from $88.20 per day up to $143.98 per day. By comparison, the federal rate for Los Angeles is $110.00 per day. (Of the seven contractors, all but contractor E reported average per diem rates less than the federal rate for this location). Also, St. Louis, Missouri, has a federal per diem rate per day of $78.00, while the contractors reported per diem rates ranging from $53.54 per day to $106.40 per day. We did not find out the reasons for the large differences in reported per diem costs for the same locations. However, lodging in different areas within a location can result in different per diem costs and may account for some of this difference.

**Table I.2: Comparison of Per Diem Costs[a] In the 10 Most-Traveled Cities in Our Sample.**

| Cities | Govt. per diem[c] | Contractors[b] | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G |
| Los Angeles, Calif. | $110 00 | $88 20 | $90 05 | $96 86 | $92 60 | $143 98 | $104 73 | $102 15 |
| San Diego, Calif. | 100 00 | 85 58 | 0 | 73 84 | 77 37 | 119 80 | 105 50 | 108 97 |
| Wash D C. | 112 00 | 110 01 | 0 | 108 05 | 99 31 | 142 19 | 111 30 | 117 73 |
| New York, N Y. | 126 00 | 154 16 | 0 | 0 | 0 | 183 72 | 128 69 | 0 |
| Dallas/Fort Worth, Texas | 107 00 | 85 66 | 0 | 67 48 | 84 53 | 98 76 | 90 79 | 117 99 |
| Dayton, Ohio | 78 00 | 104 51 | 94 69 | 0 | 0 | 98 39 | 113 55 | 76 09 |
| Savannah, Ga. | 66 00 | 48 75 | 0 | 0 | 0 | 0 | 67 21 | 0 |
| St Louis, Mo | 78 00 | 53 54 | 0 | 74 69 | 64 62 | 106 40 | 79 14 | 93 67 |
| Ontario, Calif. | 71 00 | 76 09 | 0 | 0 | 0 | 0 | 0 | 0 |
| Seattle, Wash. | 86 00 | 90 35 | 65 50 | 90 61 | 0 | 94 93 | 95 93 | 94 65 |

[a]A zero indicates no data was received

[b]We did not include one contractor in the per diem cost comparisons because it was not able to provide meal and incidental expense costs

[c]We used the maximum federal per diem rates that were in effect during January and February 1987

We also compared the average lodging cost the 8 contractors provided for the 10 most-traveled locations against the government maximum lodging rate. As with the overall per diem rates, large differences exist among contractors' lodging costs. (See table I.3). In some cities, lodging costs were higher than the government's maximum lodging rates. (See table I.3.) For example, three contractors reported lodging costs for New York City, and all three contractors' costs exceeded the government's maximum lodging rate. In addition, the government's maximum lodging rate for Seattle, Washington, was exceeded by six of the seven contractors which provided lodging cost for this city. GSA has since increased the federal per diem rates for some of these and other cities, effective August 1, 1987.

**Table I.3: Comparison of Lodging Costs[a] in the 10 Most-Traveled Cities in Our Sample.**

| Cities | Govt. lodging rates[b] | Contractors | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | A | B | C | D | E | F | G | H |
| Los Angeles, Calif | $77 00 | $56 23 | $56 32 | $73 44 | $70 08 | $122 58 | $72 92 | $75 04 | $50 42 |
| San Diego, Calif | 67 00 | 35 44 | 0 | 49 09 | 55 02 | 92 74 | 73 39 | 82 31 | 59 22 |
| Wash., D C | 79 00 | 71 85 | 0 | 87 31 | 88 41 | 113 54 | 79 10 | 92 13 | 69 24 |
| New York, N Y | 93 00 | 110 16 | 0 | 0 | 0 | 110 79 | 95 65 | 0 | 0 |
| Dallas/ Fort Worth, Texas | 74 00 | 51 89 | 0 | 44 52 | 66 72 | 72 20 | 60 89 | 89 35 | 33 30 |
| Dayton, Ohio | 53 00 | 75 52 | 64 48 | 0 | 0 | 72 04 | 77 91 | 58 15 | 47 96 |
| Savannah, Ga | 41 00 | 24 92 | 0 | 0 | 0 | 0 | 34 83 | 0 | 39 19 |
| St Louis, Mo | 53 00 | 34 17 | 0 | 53 61 | 49 71 | 80 10 | 48 24 | 66 37 | 0 |
| Ontario, Calif | 46 00 | 48 82 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Seattle, Wash | 53 00 | 69 24 | 43 00 | 66 78 | 0 | 69 99 | 62 82 | 72 27 | 58 66 |

[a]A zero indicates no data was received

[b]We used the maximum lodging rates that were in effect during January and February 1987. Government contractor reimbursements are not restricted by these maximum lodging rates, but are limited to the overall maximum federal per diem rates.

## Efforts by Contractors and GSA to Reduce Lodging Costs

Of the eight contractors contacted, seven said they are or have been negotiating with motels and hotels to obtain the government rates or discounts in selected cities. According to three contractors, they have negotiated with major hotel chains to obtain greater discounts or government-rate lodging. The other four contractors said they have negotiated with hotels in their most frequently visited locations. Only one contractor told us that its effort consisted of asking for a discount at time of reservation. According to the contractor, a negative response did not necessarily affect the booking.

GSA has also asked hotels and motels to extend the government-rate discounts to government contractors, according to the Federal Supply Service's Director, Travel and Transportation Management Division, who oversees the hotel and motel discount program. This effort has increased the number of hotels and motels offering the government-rate discounts to government contractors. The GSA's 1987 Federal Hotel/ Motel Discount Directory lists approximately 7,500 lodging establishments which offer discounted rates for government employees. According to GSA, managers of nearly 5,000 of these properties, or 66.7 percent, have agreed to extend the discount rate to cost-reimbursable or all-government contractors traveling on official business. For fiscal year 1987, the Federal Supply Service for the first time asked hotels and motels to

extend these discount rates to all government contractors. This is a 56-percent increase above the number of hotels and motels offering these discounts in the 1986 directory. The 1986 directory listed more than 5,700 lodging establishments and over 3,200 properties, or 56.1 percent, had agreed to extend their rates to government cost-reimbursable contractors traveling on official business.

The hotels and motels that have agreed to extend their discount rates to government contractors on official government business may require that the government contractors furnish a letter of identification signed by the authorizing agency's contracting officer. GSA issued a bulletin on August 15, 1986, informing the heads of federal agencies of this requirement. According to GSA Federal Supply Service's Director, Travel and Transportation Management Division, contracting officers have been reluctant to sign a standard letter of identification that would allow the government contractors access to the discount rates. For example, according to one contractor, the administrative contracting officer has not issued a letter identifying it as a cost-reimbursable government contractor as requested because the contractor had not substantiated the need for the letter (e.g., provided examples where hotels denied the government rate). According to the Director, the reluctance on the part of contracting officers to issue a standard letter of identification is the missing link between contractors being eligible for and receiving government discounts. The Director believes a change to the Federal Acquisition Regulations may be necessary to ensure that identification letters are issued.

## Contractors Will Reimburse Employees for Actual Costs

According to five of the eight contractors, no changes were made to their travel cost reimbursement policies in response to Public Law 99-234, although there are limits on allowable per diem costs that may be applied toward government contracts. The remaining three contractors have modified travel cost reimbursement policies and procedures. For example, one contractor has instituted a policy to limit reimbursement for most travelers to actual amounts for meals and incidental expenditures not to exceed that portion of the maximum federal per diem for the travel location, and also to prescribe the use of a corporate list of hotels.

Of the eight contractors, six have modified their procedures and accounts to capture the unallowable costs under the new travel regulations. However, only three of the eight contractors contacted elected to wait to implement the new travel regulations. Two contractors elected to

wait until January 1, 1987, as allowed by the DAR Council, and the other contractor waited until October 1, 1986. The cost increases associated with this effort was noted by three contractors. For example, one contractor estimated that at one location alone, the more complicated system (necessary for using and auditing the per diem rates) requires additional time for each traveler to prepare the expense reports and incremental processing time by travel audit staff of approximately 20 percent. For that one location, the contractor stated that these supplemental efforts result in an estimated additional cost of $100,000 to $150,000.

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